Centrum für Europäische Politik

CEP Default Index

Country Report Italy – 1st half of 2011

Creditworthiness Trends, Causes and Reform Prospects

– Abstract[1] –

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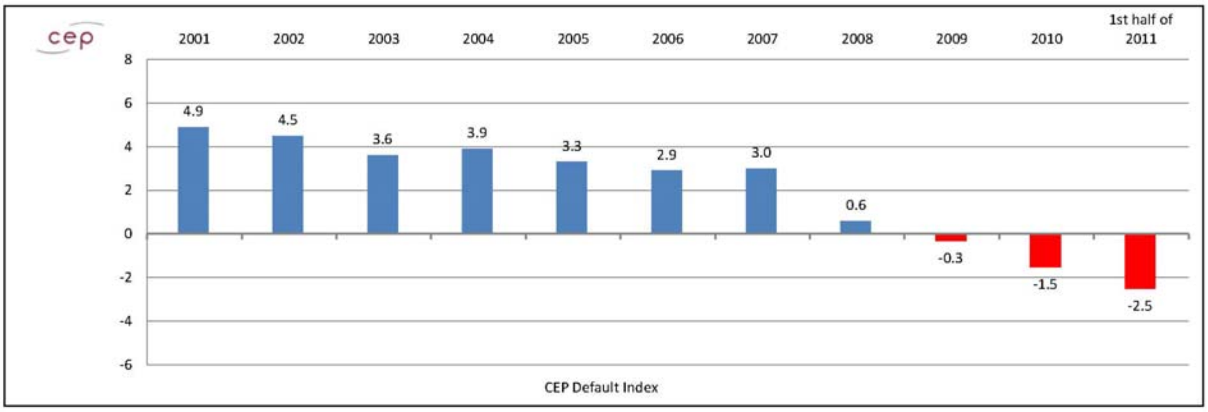
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	1st half of 2011
NTE	0.4	-0.3	-0.6	-0.2	-0.8	-1.4	-1.2	-2.9	-2.0	-3.5	-4.4
I^c	4.5	4.8	4.2	4.1	4.1	4.3	4.2	3.5	1.7	2.0	1.9
CEP Default Index	**4.9**	**4.5**	**3.6**	**3.9**	**3.3**	**2.9**	**3.0**	**0.6**	**-0.3**	**-1.5**	**-2.5**
Risk category	1	2	2	2	2	2	2	2	3	3	4



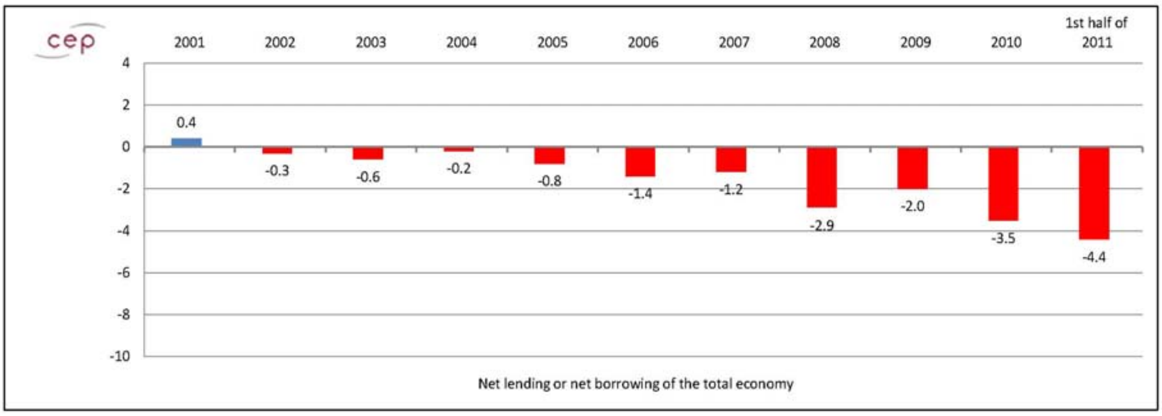
[1] The long version can be found under http://www.cep.eu/fileadmin/user_upload/CEP-Default-Index/Italien_2011.pdf (in German only).

The CEP Default Index[2]

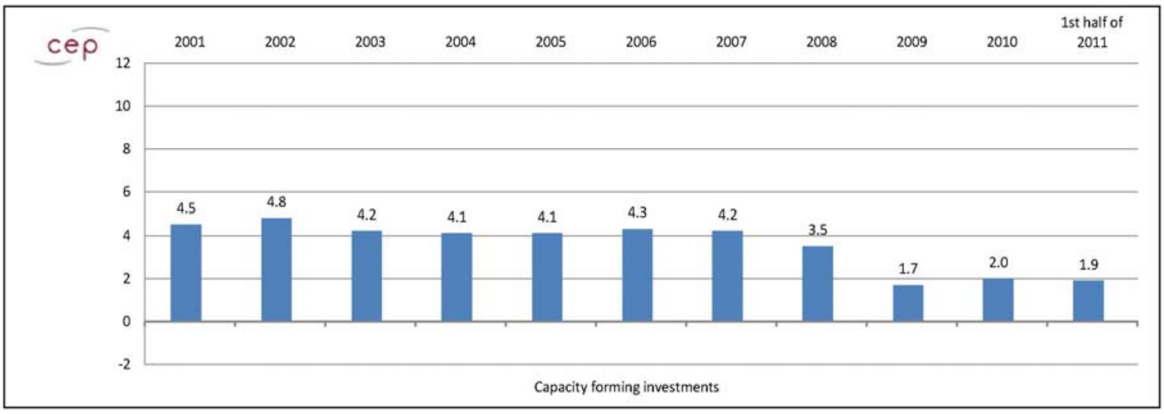
The CEP Default Index measures the development of the individual countries' capability to pay back foreign credits. The Index assesses the net lending or net borrowing of the total economy (NTE) and the resources used to increase physical capital stock, that is capacity forming investments (I^c) for a certain period. Both values are measured as a percentage of gross domestic product (GDP). Negative index values indicate an erosion of creditworthiness.

CEP Default Index for Italy: Findings

- There was a significant acceleration of the erosion of Italy's creditworthiness in the first half of 2011: the CEP Default Index dropped from -1.5 to -2.5 (see front page), thereby consolidating the threat of insolvency in Italy.
- The key causes of this trend are:
  - Since 2002, the Italian economy has been increasingly taking foreign credits. In the first half of 2011 net credit demand also increased and grew to 4.4% of GDP.



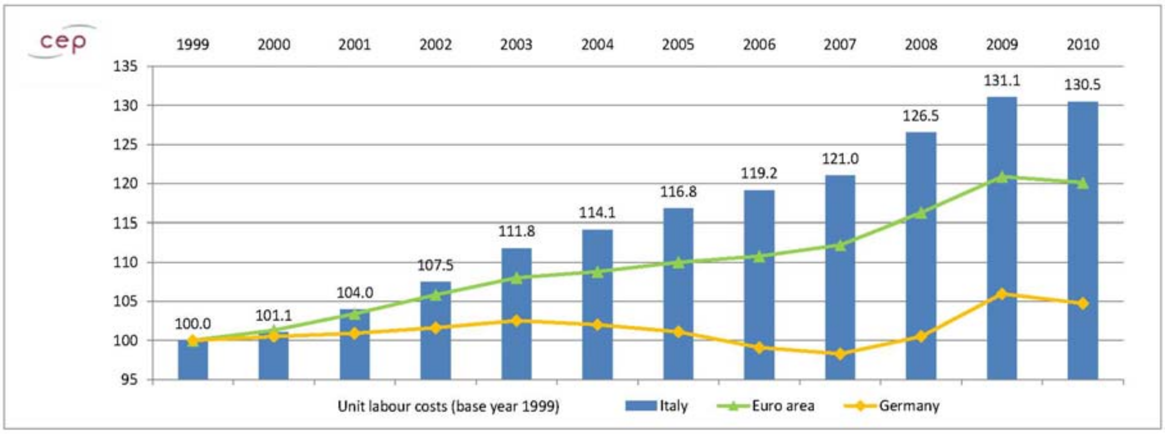
  - Since 2009, capacity forming investments have been less than half of what they were until 2007; this did not change in the first half of 2011.



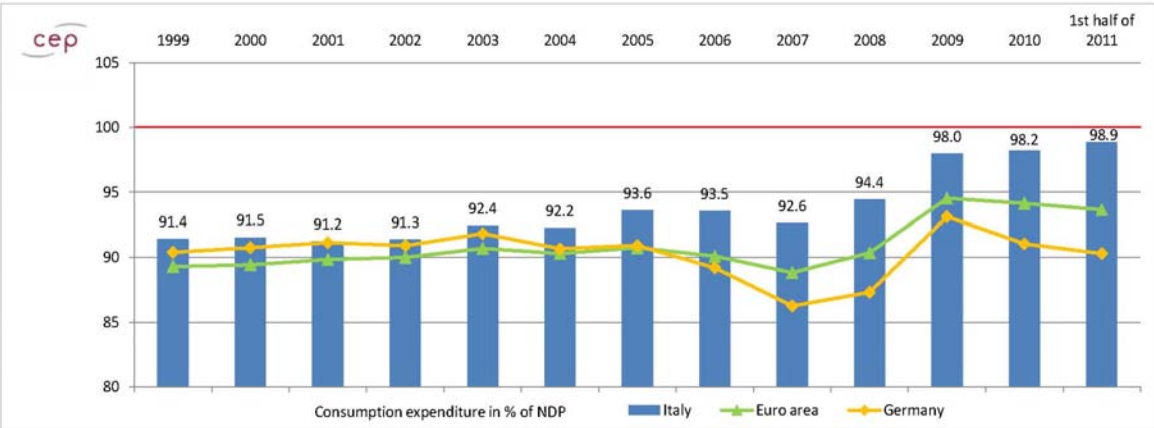
[2] For a detailed presentation, see CEP Analysis "CEP Default Index" under http://www.cep.eu/en/analyses-of-eu-policy/economic-stability-policy/cep-default-index/.

Causes of the Erosion of Italy's Creditworthiness

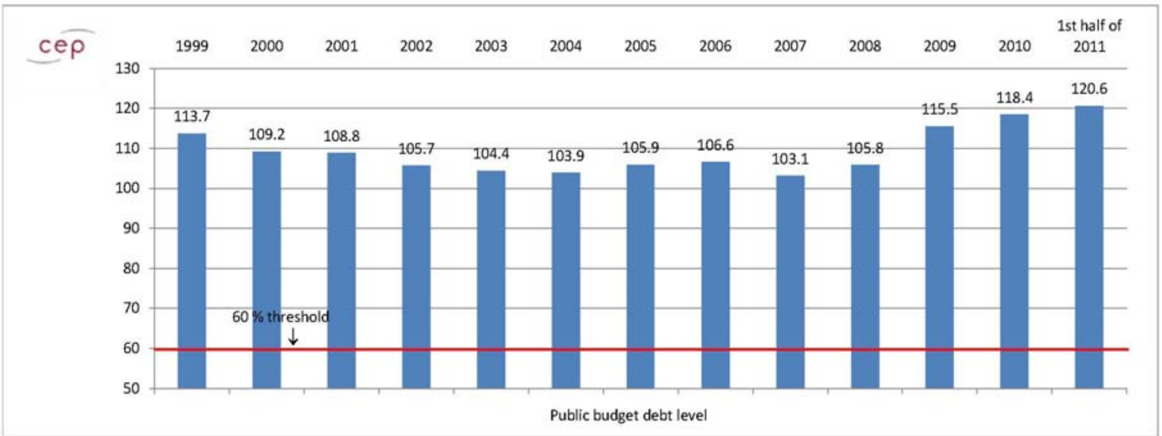
- The key cause is that Italy has lost its competitiveness against other Euro countries: Italy's unit labour costs have grown by 30.5% since 1999, German's by 5%. The difference of 25.5 percentage points indicates a gap in competition.



- This has been further aggravated by the fact that the share of consumption expenditure represents almost 100% of net domestic product, which means that there are almost no funds left for urgently needed investments which could help boost Italy's competitiveness.



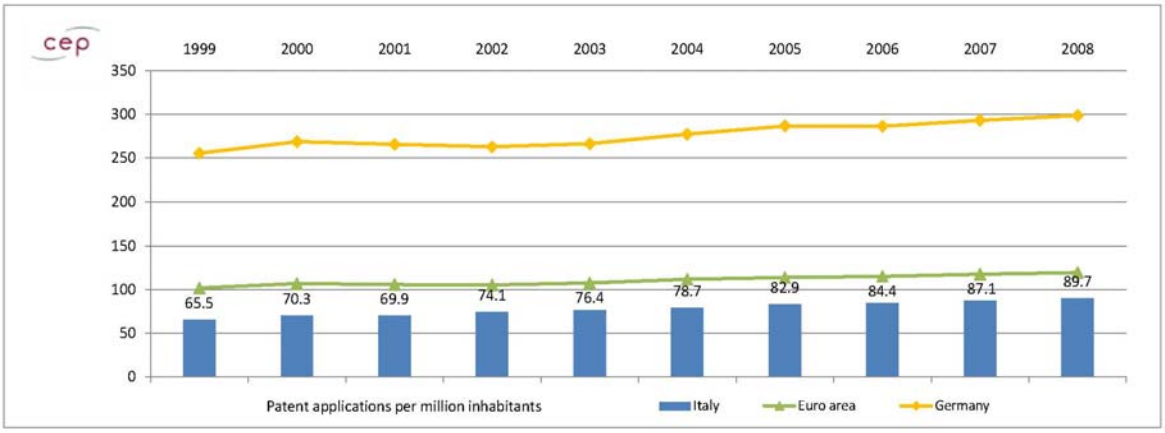
- Moreover, the debt level of the Italian state lies above 120% of GDP; this fosters mistrust in its capability to pay back credits.



- There is a substantial gap in production and prosperity between the north and south of Italy.

Reform Prospects

- Without fundamental and fast acting reforms, the erosion of Italy's creditworthiness will soon result in insolvency. The future of the Eurozone depends on Italy's willingness for reforms.
- Italy must – like other Southern European economies – quickly reduce its macroeconomic need for foreign credits. This requires the elimination of current account deficits, which is a precondition of the restoration of competitiveness.
- Italian competitiveness can be improved through productivity growth at best only in the long term, as it would require considerably increasing investment and innovation activities. Here, Italy has a very high backlog demand. In 2008 only 90 patents were registered with the European Patent Office; in Germany the number was three times as high.



- The only realistic possibility for achieving the necessary restoration of competitiveness is a cut in workers' salaries. This is subject to the workers' and trade unions' willingness to cooperate. Decisive in this question is whether or not the erosion of Italian creditworthiness can be stopped.
- A supportive measure must be the liberalisation of labour and goods markets.
- The tax system should be restructured in such a way that the burden upon labour is reduced and consumption is more heavily taxed instead.
- In addition, fiscal policy is necessary which is strictly focussed on stability.